No. 12143

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WALTS, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONER.

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TOPICAL INDEX

INDEX TO APPENDIX

TABLE OF AUTHORITIES CITED.

CASES. PAGE

STATUTES PAGE

TEXTBOOKS

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Opinion Below.

The memorandum findings of fact and opinion of the Tax Court [R. 47-61] are not reported.

Jurisdiction.

The petition for review [R. 69-77] involves the determination of deficiencies in federal corporation declared value excess-profits tax, and excess profits tax, for the taxable calendar year of 1942. [R. 5, 20, 47.] On October 27, 1944, respondent mailed to petitioner the required statutory notice of deficiency. [R. 11-20.] Within ninety days thereafter, on January 23, 1945, petitioner filed a petition with the Tax Court of the United States for redetermination of those deficiencies, pursuant to the provisions of Section 272 of the Internal Revenue Code. [R. 1, 5-21.] An amendment to petition was filed on June 18, 1946. [R. 21-23.] Respondent filed answers to the petition and amendment to petition. [R. 20-21, 23-24.] The

proceeding was tried on June 18, 1946, at Los Angeles before Judge Eugene Black, who was designated, pursuant to Section 1103, Internal Revenue Code, as a one-judge Division to hear and determine this case. [R. 2, 61-62.] A partial stipulation of facts was filed [R. 24-45], and both oral and documentary evidence were introduced by petitioner. No witnesses were produced by respondent. On January 17, 1947, memorandum findings of fact and opinion, by Judge Byron B. Harlan, were promulgated. [R. 3, 47-61.] Petitioner's motion for rehearing *de novo,* filed February 17, 1947, was denied by Judge Byron B. Harlan on February 17, 1947. [R. 61-65.] On April 10, 1947, the Tax Court, by Judge Harlan, entered its final order and decision redetermining deficiencies for 1942 of $955.20 in declared value excess-profits tax and $27,942.80 in excess profits tax. [R. 66.] On April 18, 1947, petitioner filed a motion to correct the decision in respect of the 10 per cent post-war credit to which petitioner concededly [R. 67] was entitled, under Sections 780 and 781(c) of the Internal Revenue Code, in connection with the determined deficiency. [R. 67-68.] This motion was denied on April 21, 1947. [R. 68.]

The case is brought to this Court by taxpayer's petition for review filed July 7, 1947 [R. 69-77], pursuant to the provisions of Sections 1141-1142 of the Internal Revenue Code. On August 12, 1947 [R. 80], December 12, 1947 [R. 81-82], January 29 [R. 82], April 12 [R. 83], July 8 [R. 83-84], October 13 [R. 84], December 14 [R. 85] and December 29, 1948 [R. 223], this Court timely entered orders extending the time for filing the certified record on review. This appeal and the transcript of record were duly filed and docketed in this Court on January 3, 1949. [R. 221.]

Statement of the Case.

1. This proceeding is to review a decision of the Tax Court, which redetermined federal corporate tax deficiencies against petitioner for 1942 in the amounts of $955.20 declared value excess-profits tax and $27,942.80 excess profits tax. This case was assigned for hearing and decision to Judge Eugene Black, sitting as a one-judge Division (No. 15) of the Tax Court. Judge Black heard the testimony of four witnesses for petitioner and received documentary evidence in the trial of the case at Los Angeles. Nearly six months thereafter, without notice to petitioner and without any order entered or docketed in the case with respect thereto, the proceeding was decided and determined by Judge Byron B. Harlan (Division No. 11), a then recently appointed judge who was not present at the time of trial and who did not see or hear the four witnesses who testified for petitioner. Judge Black at all times continued to function and serve as a judge of the Tax Court. [R. 64.] No reason was assigned for the sudden entry of Judge Harlan into the case. Following notice of filing by Judge Harlan of memorandum findings of fact and opinion, petitioner's motion for rehearing *de novo* [R. 61-65] was promptly filed, and denied by Judge Harlan. [R. 65.] Petitioner's motion, among other things, challenged Judge Harlan's authority to act.

Therefore, the first question presented is whether Judge Harlan's memorandum findings of fact and opinion should be vacated and the decision based thereon reversed and the case remanded for a new trial, in view of the deprivation of petitioner not only of its right to a "public hearing," as provided by Section 1116, Internal Revenue Code, but also of its concomitant right to a decision or determination of the issues and to findings of fact by the trial judge,

as provided by Sections 1117(b) and 1118(a), Internal Revenue Code, and required by the "due process" clause.

2. The next and related question is: Did the Tax Court err in denying petitioner's motion for rehearing *de novo* in view of the facts stated above and the grounds set forth in the motion?

3. Under Rule 35(b) of the Tax Court, a petitioner, in its opening brief in that court, is required to set forth in numbered fashion complete statements of the facts "based upon the evidence," giving references to the transcript pages and exhibits in support of each statement. This the petitioner did in 24 numbered statements in its opening brief. Rule 35(b) also provides that "If the other party disagrees with any or all of the statements of fact," he "shall give the same numbers to his statements of fact as appear in his opponent's brief" and "his statement of fact shall be set forth in accordance with the requirements above designated." By operation of Rule 35(b), respondent accepted 19 of petitioner's statements in their entirety and partially accepted petitioner's five remaining statements. Respondent had not offered any testimony in rebuttal of the testimony of petitioner's witnesses. The Tax Court ignored its own Rule 35(b) in failing to adopt such accepted statements of fact in its findings of fact, and failed to refer to or explain its failures so to do either in its opinion or elsewhere, notwithstanding the petitioner, in its answering brief, expressly claimed the benefit of Rule 35(b). [R. 63.] The Tax Court findings not only failed to include petitioner's con-

ceded statements of fact but such findings were in material respects inconsistent therewith. This entire matter was called to the Tax Court's attention by petitioner in its aforesaid motion for rehearing *de novo*. [R. 63.]

The question presented is: Did the Tax Court's failure, and subsequent refusal to apply its own Rule 35(b), under the circumstances, constitute prejudicial and reversible error, even apart from the other errors relied upon?

4. The next question for review is—

Under Section 23(a)(1)(A), Internal Revenue Code, were salary or compensation payments of $28,000 each to petitioner's two managing officers, Cunningham and Morse, reasonable in amount and deductible in their entirety in computing petitioner's 1942 income? The entire evidence has been brought up for review.

On its return for 1942, petitioner claimed a deduction for $56,000, representing $28,000 each, incurred and paid by petitioner to Walter J. Cunningham and Elmer D. Morse, its two managing officers, during 1942, pursuant to previous corporate authorization therefor, for services actually performed by them. Respondent, in his statutory notice of deficiency, determined that only $10,000 for each of the two officers was allowable as a deduction to petitioner for tax purposes for 1942. Petitioner petitioned the Tax Court to redetermine respondent's deficiency determination, and the Tax Court (by Judge Harlan) affirmed the two $10,000 salary allowances and disallowed the remaining $36,000 of the aggregate salary deductions of $56,000 claimed in petitioner's return. In this pro-

ceeding for review, petitioner still claims that it is entitled to deduct the full $56,000 of compensation incurred and paid by it to Mr. Cunningham and Mr. Morse in 1942, pursuant to corporate authorization therefor, for services actually rendered. We challenge Judge Harlan's adverse findings and conclusions as being clearly erroneous.

5. On April 18, 1947, petitioner filed a motion to correct the decision entered April 10, 1947, which motion was denied on April 21, 1947, by Judge Harlan. [R. 67-68.] The ground of the motion was that the Tax Court failed, in entering its decision under Rule 50, to allow or make proper adjustment in its deficiency computation for the ten per cent (10%) post-war credit of $4,944.01 provided for under Sections 780 and 781, Internal Revenue Code, and set forth in respondent's computation for entry of decision [R. 229, before this Court in original form]. The question with respect to this matter is: Was it error for the Tax Court to have failed to give effect, in its decision redetermining the tax deficiency, to this concededly necessary adjustment in connection with the tax resulting from its affirmance of respondent's action in disallowing an aggregate of $36,000 of the disputed salary deductions?

Statutes, Regulations, etc., Involved.

These are set forth in the Appendix, *infra*.

Specification of Errors Relied Upon.

The assignments of error relied upon are set forth in the record at pages 74-76 and 223-225, respectively. Petitioner relies upon the errors so assigned, but for convenience summarizes them as follows:

The Tax Court erred—

1. In permitting, contrary to law and the "due process" requirement, the determination of the proceeding by a judge who did not try the case, hear the evidence or observe the witnesses. [Assignments 2, 4; R. 74, 223.]

2. In denying petitioner's motion for rehearing *de novo,* where the proceeding was determined by a judge who did not try the case. [Assignment 3; R. 74, 223.]

3. In failing to allow to petitioner, in its decision entered pursuant to Rule 50, the ten per cent (10%) post-war credit of $4,944.01 admittedly allowable under Sections 780 and 781, Internal Revenue Code, and in denying petitioner's motion to correct its decision in respect thereof. [Assignment 1; R. 74, 223.]

4. In failing to make findings in accordance with certain undisputed facts proved by the evidence, where respondent had by virtue of Tax Court Rule 35(b) conceded the correctness of petitioner's statements of such facts. [Assignments 10, 11; R. 76, 223.]

5. In making findings contrary to the undisputed testimony of petitioner's witnesses, where the judge making such findings had no opportunity to judge the credibility of such witnesses. [Point (f); R. 224-225.]

6. In that its findings of fact are clearly erroneous in the following material respects:

(a) The finding and holding that "a reasonable allowance for salary for the services rendered by

Walter J. Cunningham and Elmer D. Morse to the petitioner * * * during the year 1942 was $10,000 per annum for each" is not supported by the evidence and is contrary to the undisputed evidence. [Point (d); R. 224.]

(b) In holding and concluding [R. 60] that "the evidence presented indicates a studied plan to anticipate profits to be earned and distribute them in the guise of compensation rather than as dividends," in view of the fact that no such issue was presented by the original or amended pleadings, and respondent had not assigned any such contention in his deficiency determination. [Assignment 9; R. 75-76, 223.]

7. In failing to find the following material facts, which were proved by undisputed evidence:

(a) That petitioner would have been obliged to pay more than $42,000 to others, if it had hired such other persons to perform the services which Cunningham rendered for petitioner in 1942. [Assignment 11; R. 76, 223.]

(b) That not less than $28,000 was a reasonable allowance for salary for services rendered by Cunningham to petitioner in 1942. [Point (g); R. 225.]

(c) That $28,000 was a reasonable allowance for salary for services rendered by Morse to petitioner in 1942. [Point (g); R. 225.]

(d) That all facts as stipulated were true. [Assignment 8; R. 75, 223.]

8. In entering decision for respondent and in failing to find and conclude that there were no deficiencies in tax due from petitioner for 1942. [Points (a), (b) and (c); R. 224.]

Summary of Argument.

Petitioner was entitled to have this proceeding both "heard and determined" by Judge Black, to whom it was assigned, and was deprived of "due process" by virtue of the failure of the Tax Court to comply with mandatory statutory requirements in respect thereof.

Petitioner's motion for rehearing *de novo* should have been granted on the grounds set forth therein.

Assuming, *arguendo,* that a deficiency existed for 1942, petitioner was entitled to a 10 per cent post-war credit thereagainst and its motion to correct the Tax Court's decision to give effect thereto should have been granted.

The compensation of $28,000 each paid to Cunningham and Morse for 1942 was not in excess of reasonable compensation for services rendered by them and should have been allowed by the Tax Court, in view of the undisputed evidence.

The Tax Court should have found the facts as stipulated, as conceded by respondent by operation of Tax Court Rule 35(b), and as required by the undisputed evidence.

The Tax Court's findings and conclusions concerning the material and ultimate facts are clearly erroneous and its decision thereon should be reversed.

ARGUMENT.

I.

The Tax Court Erred in Permitting, Contrary to Law and the "Due Process" Requirement, the Determination of the Proceeding by a Judge Who Did Not Try the Case, Hear the Evidence, or Observe the Witnesses.

On June 18, 1946, this proceeding was heard by Judge Eugene Black on the merits. [R. 2.] Four witnesses testified on behalf of petitioner. [R. 100 to 218.] A partial stipulation of facts and numerous exhibits were filed. [R. 24-45, 91, 90-218.]

On January 17, 1947, memorandum findings of fact and opinion by Judge Byron B. Harlan were entered. [R. 3, 47-61.]

The record of docket entries from June 18, 1946, to January 17, 1947, inclusive [R. 2-3], does not disclose that any order was made by the Presiding Judge of the Tax Court, by Judge Black, or by any other judge, transferring the cause from Judge Black, who heard the evidence, to Judge Harlan, who did not.

The record is likewise silent as to any notice to petitioner that Judge Black would not determine the proceeding or that Judge Harlan would determine it. No such notice was ever given.

Moreover, the record does not show that petitioner stipulated or otherwise consented to the determination of the proceeding by Judge Harlan, and in fact, no such stipulation was ever made or consent given.

On February 12, 1947, petitioner transmitted to the Tax Court a motion for rehearing *de novo,* which was denied on February 17, 1947. [R. 61-65.] Said motion

was based on the grounds that Judge Harlan had no authority or power to determine the proceeding and that petitioner was materially prejudiced and aggrieved by his attempted exercise of jurisdiction. [R. 61-65.] The motion also specifically called attention to the above-mentioned state of the record and docket.

We contend that the determination of petitioner's proceeding by Judge Harlan constituted a violation of the "due process" clause, and that the Tax Court also violated the provisions of Sections 1116, 1117(b) and 1118(b), Internal Revenue Code (Appendix, *infra*), in permitting the determination of the case by a judge who did not try it. Our motion for rehearing also embodied the latter grounds.

It is well established that the constitutional requirement of due process is binding on the Tax Court, whether that tribunal be considered an administrative agency or a court.

Apropos here, is *Morgan v. United States,* 298 U. S. 468, in which it was held that an order of the Secretary of Agriculture fixing and determining maximum rates to be charged by market agencies for buying and selling livestock at Kansas City Stock Yards was void because the Secretary, without hearing the evidence, undertook to make the findings and fix the rates. The hearing directly involved "the *reasonableness* of existing rates." (Italics supplied.) (P. 472.) Appellants attacked the order "as illegal and arbitrary and as depriving (appellants) of their property without due process of law in violation of the Fifth Amendment of the Constitution."

The Supreme Court held (p. 477):

"These suits for the review of the administrative action were thus directly authorized and appeal lies under the Urgent Deficiencies Act of October 22, 1913. * * * All questions touching the regularity and validity of the proceeding before the Secretary are open to review. * * * When the Secretary acts within the authority conferred by the statute, his findings of fact are conclusive. * * * But, in determining whether in conducting an administrative proceeding of this sort the Secretary has complied with the statutory prerequisites, the recitals of his procedure cannot be regarded as conclusive. Otherwise the statutory conditions could be set at naught by mere assertion. If upon the facts alleged, the 'full hearing' required by the statute was not given, plaintiffs were entitled to prove the facts and have the Secretary's order set aside. Nor is it necessary to go beyond the terms of the statute in order to consider the constitutional requirement of due process as to notice and hearing. For the statute itself demands a full hearing and the order is void if such a hearing was denied. * * *

"What is the essential quality of the proceeding under review, and what is the nature of the hearing which the statute prescribes?

"The proceeding is not one of ordinary administration, conformable to the standards governing duties of a purely executive character. It is a proceeding looking to legislative action in the fixing of rates of market agencies.

"A proceeding of this sort requiring the taking and weighing of evidence, determinations of fact based upon the consideration of the evidence, and the

making of an order supported by such findings, has a quality resembling that of a judicial proceeding. Hence it is frequently described as a proceeding of a *quasi-judicial* character. The requirement of a 'full hearing' has obvious reference to the tradition of judicial proceedings in which evidence is received and weighed by the trier of the facts. The 'hearing' is designed to afford the safeguard that the one who decides shall be bound in good conscience to consider the evidence, to be guided by that alone, and to reach his conclusion uninfluenced by extraneous considerations which in other fields might have play in determining purely executive action. The 'hearing' is the hearing of evidence and argument. If the one who determines the facts which underlie the order has not considered evidence or argument, it is manifest that the hearing has not been given.

"There is thus no basis for the contention that the authority conferred by Sec. 310 of the Packers and Stockyards Act is given to the Department of Agriculture, as a department in the administrative sense, so that one official may examine evidence, and another official who has not considered the evidence may make the findings and order. In such a view, it would be possible, for example, for one official to hear the evidence and argument and arrive at certain conclusions of fact, and another official who had not heard or considered either evidence or argument to overrule those conclusions and for reasons of policy to announce entirely different ones. It is no answer to say that the question for the court is whether the evidence supports the findings and the findings support the order. For the weight ascribed by the law to the findings—their conclusiveness when made within the sphere of the authority conferred—rests upon

the assumption that the officer who makes the findings has addressed himself to the evidence and upon that evidence has conscientiously reached the conclusions which he deems it to justify. That duty cannot be performed by one who has not considered evidence or argument. It is not an impersonal obligation. It is a duty akin to that of a judge. The one who decides must hear.

"This necessary rule does not preclude practicable administrative procedure in obtaining the aid of assistants in the department. Assistants may prosecute inquiries. Evidence may be taken by an examiner. Evidence thus taken may be sifted and analyzed by competent subordinates. Argument may be oral or written. The requirements are not technical. But there must be a hearing in a substantial sense. And to give the substance of a hearing, which is for the purpose of making determinations upon evidence, the officer who makes the determinations must consider and appraise the evidence which justifies them. That duty undoubtedly may be an onerous one, but the performance of it in a substantial manner is inseparable from the exercise of the important authority conferred."

We have quoted from the *Morgan* case at length as a substitute for argument by us, since we could never express the thoughts of Mr. Chief Justice Hughes on the important "due process" question here involved, in more lucid or forceful language than he employed.

The instant proceeding before the Tax Court was, to say the least, "a proceeding of a *quasi-judicial* character." The Tax Court certainly exercised judicial functions; it is called a "court" and its members are called "judges."

Section 1116, Internal Revenue Code (Appendix, *infra*), requires that the hearing before a division of the Tax Court shall be a public hearing. Certainly, the hearing before the Tax Court is to be of no less dignity than the hearing discussed above in the *Morgan* case.

Section 1117(b), Internal Revenue Code, provides:

> "Inclusion of Findings of Fact or Opinions in Report.—*It shall be the duty* of the Board and *of each division to include in its report* upon any proceeding *its findings of fact* or opinion or memorandum opinion. The Board shall report in writing all its findings of fact, opinions and memorandum opinions." (Italics supplied.)

Section 1118(a), Internal Revenue Code, provides:

> "Hearings, Determinations, and Reports.—*A division shall hear, and make a determination upon, any proceeding* instituted before the Board and any motion in connection therewith, *assigned to such division* by the chairman, and shall make a report of any such determination which constitutes its final disposition of the proceeding." (Italics supplied.)

Pursuant to Section 1103, Internal Revenue Code, Judge Eugene Black was designated and assigned by the Presiding Judge of the Tax Court as a one-judge Division to hear and determine, among others, petitioner's proceeding at Los Angeles in June, 1946. [R. 61-62.] According to C. C. H. Tax Court Reporter's weekly reports published February 15, 1946, and August 2, 1946, respectively, the Presiding Judge "divided the Tax Court into one-member Divisions, each authorized to hear and decide cases. * * * Division assignments are as follows (as of February 15, 1946): * * * Division 11 * * *

Arthur J. Mellott * * * Division 15 * * * Eugene Black." As of August 2, 1946, according to the C. C. H. report, "Division assignments are as follows: Division 11 * * * Byron B. Harlan" (term commenced June 2, 1946); "Division 15 * * * Eugene Black."

The current C. C. H. Tax Reporter shows that Judges Harlan and Black still are assigned to Divisions 11 and 15, respectively.

From all of the foregoing, it is clear that petitioner was entitled to a public hearing at which the judge assigned to try petitioner's proceeding was charged by law with the duty both of hearing the evidence and determining the issues involved by making, initially at least, the findings of fact and entering conclusions of law thereon.

The power of this Court to review the regularity and validity of the proceeding below is conferred by Section 1141, Internal Revenue Code, which provides:

> "The Circuit Courts of Appeal * * * shall have exclusive jurisdiction to review the decisions of the Tax Court, * * * , in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgments of any such court shall be final, * * *."

Proceedings before the Tax Court are thus unquestionably placed upon the same footing as those before other courts. This is also true insofar as the due process requirement of the Fifth Amendment to the Constitution is concerned.

And, as Mr. Chief Justice Hughes stated (p. 477):

> "All questions touching the regularity and validity of the proceeding * * * are open to review."

In judicial proceedings, the cases are universally to the following effect, as held by the Supreme Court of California in *In re Sullivan,* 143 Cal. 462, 77 Pac. 153, 155:

> "A party litigant is entitled to a decision upon the facts of his case from the judge who hears the evidence, where the matter is tried without a jury, and from the jury that hears the evidence, where it is tried with a jury. He cannot be compelled to accept a decision upon the facts from another judge or another jury."

In *Clanton v. Ryan,* 14 Colo. 419, 24 Pac. 258, 259, it was held:

> "It certainly is not 'according to the rules and practice' in the trial of ordinary civil actions before a court of record for one judge to hear the evidence, or a part thereof, orally, and then for another judge to render a finding and judgment upon such evidence, however perfectly the same may have been preserved."

The rule is the same in criminal cases. It was so held in *In re Williams,* 52 Cal. App. 566, 569, where the reason for the rule in civil cases is explained. We quote (pp. 569-570):

> "The foregoing sections of the Penal Code clearly indicate to our minds that the essential procedure upon a preliminary examination of a felony charge does not differ materially from that required upon the trial of the cause. The magistrate who is to make the order either discharging the defendant or holding him to answer upon the charge must base that order upon evidence which he has admitted and upon testi-

> mony which he has heard in the usual way in which such evidence is presented and such testimony taken. He has no right to predicate his said order upon something which has not occurred before him; upon evidence the admissibility of which he has not passed upon, and upon testimony the weight and value of which he has not measured by the appearance, the narration and the manner of testifying of the witnesses present in person before him. It has been expressly held that upon the trial of a cause in a superior court judges cannot be changed in the midst of a hearing with the effect that the substituted judge could be entitled to decide the cause upon evidence which he had not himself heard or passed upon (Guardianship of Sullivan, 143 Cal. 462, (77 Pac. 153)). We are satisfied that a like procedure must obtain upon the hearing of preliminary examinations."

See also:

Connolly v. Ashworth, 98 Cal. 205, 33 Pac. 60;

City of Long Beach v. Wright, 134 Cal. App. 366, 370, 371;

La Bonte v. La Casse, 78 N. H. 489, 102 Atl. 540;

and cases cited under Argument II, *infra.*

It conclusively follows, from the foregoing, that petitioner was deprived of due process under the Fifth Amendment to the Constitution of the United States, by the erroneous attempt to assume jurisdiction by the judge who made the determination but who did not try the case, hear the evidence, or observe the witnesses. Likewise, the Tax Court violated Sections 1116, 1117(b) and 1118(a), Internal Revenue Code, *supra.*

II.

The Tax Court Erred in Denying Petitioner's Motion for Rehearing De Novo, Where the Proceeding Was Determined by a Judge Who Did Not Try the Case.

The facts sufficiently appear under Argument I, above. Petitioner gave the Tax Court ample opportunity to correct its error, by calling the matter promptly to its attention by a motion for a rehearing *de novo*.

The motion was denied by the same judge [R. 65] who, it is claimed by petitioner, had no power or authority to determine the proceeding, as demonstrated in the preceding argument.

It was error for the Tax Court to deny the motion, since a hearing *de novo* should have been granted under the circumstances. It was so held in *Wainwright v. P. H. & F. M. Roots Co.,* 176 Ind. 682, 97 N. E. 8, 14, where the Supreme Court of Indiana stated:

> "A party to an action is entitled to a determination of the issues by the jury or judge that heard the evidence, and where a case is tried by the judge, and the issues remain undetermined at the death, resignation, or expiration of the term of such judge, his successor cannot decide, or make findings in the case, *without a trial de novo.* Bahnsen v. Gilbert, 55 Minn. 334, 56 N. W. 1117; Clanton v. Ryan, 14 Colo. 419, 24 Pac. 258; Guardianship of Sullivan, 143 Cal. 462, 77 Pac. 153; Connolly v. Ashworth, 98 Cal. 205, 33 Pac. 60; Mace v. O'Reilley, 70 Cal. 231, 11 Pac. 721; Norvell v. Deval, 50 Mo. 272, 11 Am. Rep. 413; Weyman v. National Broadway Bank, 59 How. Prac. (N. Y.) 331; Putman v. Crombie, 34 Barb. (N. Y.) 232; Cain v. Libby, 32 Minn. 491, 21 N. W. 739; Ells v. Rector, 32 Mich. 379; 23 Cyc. 565." (Italics supplied.)

The Supreme Court of California similarly held in *Mace v. O'Reilley,* 11 Pac. 721, 723, where the following language appears:

> "When that judge went out of office, the trial was incomplete, and no proper judgment could be entered. *It seems to us that a new trial was inevitable,* unless agreed findings should be filed or waived by both sides to the controversy. The motion to vacate the judgment, as made, was initiated within about seven days after its rendition.
>
> "The fact that plaintiff did not formally move for a new trial, but chose rather to move to set aside and vacate the judgment, is of no material consequence. *A new trial was inevitable in either event,* and no error was committed by the court in setting aside the judgment for the want of findings. *Van Court v. Winterson,* 61 Cal. 615." (Italics supplied.)

The following quotation from *McAllen v. Souza,* 24 Cal. App. 2d 247, 251, is to the same effect:

> "In such cases it has been held, at least in the absence of consent or waiver, that no other judge may render a valid judgment *without a trial de novo,* for 'A party litigant is entitled to a decision upon the facts of his case from the judge who hears the evidence, when the matter is tried without a jury.' (*Guardianship of Sullivan,* 143 Cal. 462, 467 (77 Pac. 153); see, also, *Connolly v. Ashworth,* 98 Cal. 205 (33 Pac. 60).) In *Hughes v. De Mund, supra,* at page 368, the court quoted with approval from 33 Corpus Juris, page 973, as follows: 'Where a case is tried by the judge, and the issues remain undetermined by him, his successor cannot decide, or make findings in the case, *without a trial de novo,* and consequently he cannot, in such a case, render a valid

judgment or decree in the cause, notwithstanding the testimony may have been written down and preserved.' " (Italics supplied.)

The jealousy with which the courts of this state safeguard the right to have the trier of facts make findings and decisions thereon is best exemplified in the opinion of the Supreme Court of California in *Francis v. Superior Court,* 3 Cal. 2d 19, 28, 29. There the Supreme Court upheld the trial judge's punishment for contempt of attorneys for both parties who had stipulated to have a motion for a new trial heard and granted by a judge who did not try the case. The Supreme Court there stated:

> "It needs no argument, we think, to prove that a judge who has heard the evidence, examined the witnesses and made a study of the law applicable to the facts in the case, is best qualified to rule upon the weight and value of the testimony of such witnesses as well as upon other questions presented by the motion and which were involved in the trial of the action and to which the trial judge in most instances has given his attention and studious consideration. To have a motion for new trial heard by a judge familiar with the facts and law of the case, rather than by one totally unfamiliar with such facts and who has made no special study of the law applicable to those facts, was the very essence of Section 661 of the Code of Civil Procedure. Its requirements were therefore mandatory according to the established rule announced above."

In the instant case, the motion for a rehearing *de novo* should properly have been heard by Judge Black, who tried the case. In any event, it should have been granted, and the denial of petitioner's motion constituted prejudicial and reversible error.

III.

The Tax Court Erred in Denying Petitioner's Motion to Correct Its Decision in Respect of the Ten Per Cent Post-War Credit.

Solely on the assumption, *arguendo,* that a deficiency in petitioner's excess profits tax existed for 1942, the Tax Court erred in failing to allow the 10 per cent post-war credit there against or to make proper adjustment or provision therefor in its decision ostensibly based on respondent's proposed recomputation under Rule 50 of the Tax Court. Actually, in Respondent's Recomputation for Entry of Decision [before this Court in original form, pursuant to order, R. 229], respondent conceded by the following statement on page 2 of its attached recomputation statement, that petitioner was entitled to such credit:

"Excess profits tax, schedule 5.....$49,440.07

Credit allowable under sections 780 and 781 (10% of $49,440.07)..... $4,944.01"

The Tax Court further erred in denying [R. 68] petitioner's motion [R. 67-68] to correct its decision in respect of this matter when its failure to allow such credit, despite respondent's aforesaid concession in his recomputation, was specifically called to its attention. Petitioner made this motion to correct and revise pursuant to Tax Court Rule 19, which allows such motions.

Although the excess profits tax provisions have been repealed and do not apply to any taxable year beginning after December 31, 1945, we are concerned here with Sections 780 and 781, Internal Revenue Code.

The pertinent part of Section 780, Internal Revenue Code, provides as follows:

> "(a) *In General.*—The Secretary of the Treasury is authorized and directed to establish a credit to the account of each taxpayer subject to the tax imposed under this subchapter, for each taxable year ending after December 31, 1941 * * * and not beginning after December 31, 1943, of an amount equal to 10 per centum of the tax imposed under this subchapter for each such taxable year. * * *"

We contend that it was the duty of the Tax Court in its decision to determine the net deficiency, after giving effect to the 10 per cent credit provided for by Section 780, Internal Revenue Code. The 10 per cent credit operates automatically as a percentage reduction of any gross amount of excess profits taxes computed. Our position is substantiated by the following language of the Tax Court in *Altschul's, Inc.*, 9 T. C. 697, 699-700:

> "Section 780 (a), as amended, provides the post-war credit to the account of each taxpayer 'subject to the tax imposed under this subchapter * * * of an amount equal to 10 per centum of the tax imposed * * *.' When the tax is 'imposed' the taxpayer becomes entitled, under the statute, to the credit, and the limitation placed on the amount of the credit in section 781 (d) (not applicable to Walt's, Inc.) is only a limitation on the amount, and is not a condition precedent to the existence of the credit. * * *
>
> "That it was not the intention of Congress that the right to the credit be postponed until the taxes were paid appears not only from the language of the statute itself, but from a later statement by the Ways and Means Committee (Report, Revenue Act of

1943, p. 60) that 'Since the post-war credit is tentatively determined on the basis of the excess profits tax shown on the return,' provision was made for the adjustment upward or downward of the credit in the event of an upward or downward revision of the tax liability upon which it is based.

"* * *

"Reviewed by the Court."

The statutory plan at first provided for the issuance to taxpayers of the United States of bonds equal to 10 per cent of the excess profits taxes paid by each taxpayer. (Sec. 780, I. R. C.)

Subsequently, Section 781 (c), Internal Revenue Code, was amended by the 1945 Tax Adjustment Act to provide, in part, as follows:

"(c) * * * If after January 1, 1946, there is any credit under section 780 (a) remaining in favor of the taxpayer attributable to any taxable year for which a credit is provided in section 780 (a), such remainder shall be paid to the taxpayer in cash. No amount of any payment made under this subsection to a taxpayer shall be included in gross income."

From the foregoing, it is clear that at the time of the Tax Court's decision herein, it was not required that a taxpayer must first pay an excess profits tax deficiency for 1942 as a condition to eligibility for the credit.

It follows that the credit should have been awarded by the Tax Court in reduction of whatever excess profits tax deficiency it determined. The Tax Court erred in failing so to do and in denying petitioner's motion to correct its decision in respect thereof.

IV.

The Tax Court Erred in Failing to Find, in Accordance With the Undisputed Evidence, That Petitioner Would Have Been Obliged to Pay More Than $42,000 to Others, if It Had Hired Such Other Persons to Perform the Services Which Cunningham Rendered for Petitioner in 1942.

The following facts, among others, proved by petitioner, were not contradicted by respondent, since he offered no testimony in rebuttal:

During 1942, Cunningham did all of petitioner's metallurgical work, acted as shipping clerk, general manager of the production end of petitioner's business [R. 121-122], inspector of castings, superintendent of production [R. 123-124], pattern-maker [R. 172-173], salesman [R. 124-125], sometimes invoice clerk [R. 174], and, in addition, all of the duties of Cunningham and Morse overlapped [R. 123]. Cunningham also served as president and a director, as previously stated.

During 1942, Morse, in addition to his overlapping duties [R. 123], handled the scheduling of parts out of the foundry, the financing of petitioner's business, the payrolls, office details of every description [R. 122-123], manager [R. 215] and performed the duties of secretary and treasurer, as well as those of a director of petitioner. He also personally guaranteed bank loans to petitioner [Stip. 9] pending the establishment, through Morse's efforts, of a line of credit with the Bank of America [Stip. 17, R. 52].

Had petitioner employed a metallurgist to do Cunningham's work, $55 a week ($2,860 a year) would have been a low salary. [R. 173-174.] A shipping

clerk would have cost petitioner $1.15 to $1.20 an hour [R. 173], or $1,500 a year for 4 hours a day; an inspector of castings $350 to $450 a month [R. 123-124], or $4,200 to $5,400 a year; a superintendent of production $1,000 a month [R. 124], and a salesman at least 5%* of petitioner's gross sales [R. 124-125, 195-196, 207-208], or $22,000 for 1942, and $48,000 for 1943 [Stip. Ex. 7-G]. Five guards would have cost an aggregate of $5 an hour (day and night), which expense was eliminated by using eight of petitioner's own employees. [R. 125-126.] This saving was at least $100 a day. Cunningham believed petitioner would have had to pay to others for services similar to those rendered by Morse in 1942, every dollar which it paid to Morse. [R. 125-126.]

The Tax Court's findings against petitioner are inconsistent with the foregoing undisputed evidence.

The decisions of all of the courts are in agreement that findings of fact must be made in accordance with a petitioner's uncontradicted evidence. To make findings otherwise is to commit reversible error. In *Planters' Operating Co. v. Commissioner of Internal Revenue* (C. C. A. 8), 55 F. 2d 583, 584, 585, the rule is succinctly stated:

> "It is well established:
>
> "* * *
>
> "That it is reversible error for the Board of Tax Appeals to disregard competent relevant testimony when it is not contradicted. *Chicago, etc., Co. v. Blair* (C. C. A.) 20 F. (2d) 10; *Boggs & Buhl v.*

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*Cunningham and the two absolutely disinterested witnesses White and Temple testified to this same effect.

Commissioner (C. C. A.) 34 F. (2d) 859; *Citrus Soap Co. v. Lucas* (C. C. A.) 42 F. (2d) 372; *Pittsburgh Hotels Co. v. Commissioner* (C. C. A.) 43 F. (2d) 345; *Dempster, etc., Co. v. Burnet* (App. D. C.) 46 F. (2d) 604; *Conrad & Co. v. Commissioner* (C. C. A.) 50 F. (2d) 576."

The following explanatory statement in Volume 9, Mertens Law of Federal Income Taxation, pages 296 and 297, is supported by the authorities there cited:

> "* * * The presumption that the Commissioner's assessment of the tax is *prima facie* correct means no more than that, in the absence of evidence to the contrary, his action will be upheld, but, once there is such contrary evidence, this presumption vanishes and the case is wide open.[56] This presumption is what is often termed a 'true' presumption and is not evidence itself, but merely shifts the burden of *going forward with,* as distinguished from the *actual burden of,* proof; and once the burden of *going forward with* the proof is met, it is as though the presumption had never existed.[57] In other words, the effect of a presumption is little more than to cast upon the other party the burden of going forward. * * *."

That the presumption of the correctness of the Commissioner's determination does not constitute a species of *evidence* creating a conflict with the evidence to the contrary introduced by a taxpayer, which the Tax Court may resolve, is held by this Court in *J. M. Perry & Co., Inc. v. Commissioner,* 120 F. 2d 123, 124, where the following rule is enunciated:

> "* * * This finding is presumptively correct, that is, until the taxpayer proceeds with competent and relevant evidence to support his position, the

determination of the Commissioner stands. When such evidence has been adduced the issue depends wholly upon the evidence so adduced and the evidence to be adduced by the Commissioner. *The Commissioner cannot rely upon his determination as evidence of its correctness either directly or as affecting the burden of proof. Welch v. Helvering,* 290 U. S. 111, 115, 54 S. Ct. 8, 78 L. Ed. 212; *Helvering v. National Grocery Co.,* 304 U. S. 282, 294, 295, 58 S. Ct. 932, 82 L. Ed. 1346; *Helvering v. Talbott's Estate,* 4 Cir., 1940, 116 F. 2d 160, 162. * * *" (Italics supplied.)

The nature of the presumption of the correctness of the Commissioner's determination is thus explained in *Wiget v. Becker* (C. C. A. 8), 84 F. 2d 706, 708, cited in note 56, referred to above:

"The presumption of correctness is in the class of the 'burden of proof presumption.' *Morrison v. People of California,* 291 U. S. 82, 54 S. Ct. 281, 78 L. Ed. 664; *Casey v. United States,* 276 U. S. 413, 48 S. Ct. 373, 72 L. Ed. 632. The party against whom it is invoked must fail if he does not produce evidence against it. It is often referred to in the books as the true presumption. 'A true presumption is not evidence, though it supplies its place and requires the other party to proceed with the negative. Unless he does, he loses; when he does, the presumption is out of the case, and the issue is open.' *United States ex rel. v. Pulver* (C. C. A. 2) 54 F. (2d) 261, 263. See, also, *United States v. Le Duc* (C. C. A.

8) 48 F. (2d) 789; *Fidelity & Cas. Co. v. Niemann* (C. C. A. 8) 47 F. (2d) 1056; *Del Vecchio v. Bowers,* 296 U. S. 280, 56 S. Ct. 190, 193, 80 L. Ed. 229."

In *Whitney v. Commissioner,* 73 F. 2d 589 (C. C. A. 3), the following applicable rule is stated:

> "The Board (of Tax Appeals) and this court in reviewing the order of redetermination are confined to the facts set out in the record. The burden of proof was on the petitioner before the Board, and *if he met it, the burden shifted and the government was required to come forward with evidence to refute the evidence of the petitioner.* It did not do so and the Board cannot draw inferences and conclusions from facts or suppositions outside of the record." (Italics supplied.)

When petitioner in the instant case completed its evidence, respondent failed "to come forward with evidence to refute the evidence of the petitioner."

Moreover, the judge who made the findings here arbitrarily disregarded the testimony of petitioner's unimpeached witnesses, in that he failed to take into consideration that a witness is presumed to speak the truth. Apparently, a contrary presumption was applied to petitioner's witnesses.

In failing to make findings of fact in accordance with petitioner's undisputed evidence, the judge who determined the proceeding, likewise, failed to take into consideration

the purpose, and to avail himself of the benefits, of Tax Court Rule 35(b), which provides:

> "(b) The party having the burden of proof shall set forth complete statements of the facts based upon the evidence. Each statement shall be numbered, shall be complete in itself, and shall consist of a concise statement of the essential fact and not a discussion or argument relating to the evidence or the law. Reference to the pages of the transcript or the exhibits relied upon in support thereof shall be inserted after each separate statement.
>
> "If the other party disagrees with any or all of the statements of fact, he shall set forth each correction which he believes the evidence requires and shall give the same numbers to his statements of fact as appear in his opponent's brief. His statement of fact shall be set forth in accordance with the requirements above designated."

Petitioner, in obedience to the above rule, set forth numbered "statements of the facts based upon the evidence," with appropriate record references.*

Respondent, in his brief, failed to follow Rule 35(b), but partially disagreed with petitioner's statements numbered 6, 8, 9, 10 and 21, in its so-called "request for findings of fact," which is not provided for by the Tax Court rules.

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*The briefs filed in the Tax Court were not transmitted to the Clerk of this Court with the record. Petitioner intends to move this Court that the record be augmented to include pertinent and necessary portions of such briefs, unless respondent in its brief will concede the correctness of our statements above set forth.

By failing to disagree with petitioner's statements of facts numbered 1, 2, 3, 4, 5, 7, 11 to 20, both inclusive, 22, 23 and 24, respondent, by operation of Rule 35(b), admitted the correctness of petitioner's statements, thus numbered. (Statements numbered 18 and 19, are set forth, *verbatim,* at the commencement of this argument, with present record references.)

Rule 35(b) was undoubtedly designed to narrow the issues of fact to be determined by the trial judge in making his findings of fact.

Where the facts were not contradicted and where respondent thus conceded the correctness of petitioner's statements, it was manifest error for the Tax Court to fail to make findings in accordance with such evidence. The Tax Court should have found that Cunningham's services made a saving in other salaries to petitioner of more than $42,000. This alone justified the payment to Cunningham of the additional $18,000 which was disallowed by respondent.

Despite the fact that the evidence was uncontradicted and despite Tax Court Rule 35(b), the judge making the determination held [R. 60] "that an unimpressive attempt was made to prove that the petitioner would have had to pay more than $28,000 if it had hired others to do the work performed by Cunningham, . . ."

The prejudicial error committed by the Tax Court is self-evident.

V.

The Compensation Payments in 1942, of $28,000.00 Each to Petitioner's Two Managing Officers, Cunningham and Morse, Were Not in Excess of a Reasonable Allowance for the Services Actually Performed by Them, and All Findings and Conclusions to the Contrary Are Clearly Erroneous.

Section 23(a)(1)(A), Internal Revenue Code (Appendix, *infra*), provides that in computing net income there shall be allowed as deductions from gross income—

> "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *"

The applicable Treasury regulations (Regs. 103, Sec. 19.23(a)-6) (Appendix, *infra*), are to the same effect and provide further that—

> "The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services."

Whether compensation is "reasonable" within the meaning of the foregoing applicable provisions is a question to be determined by the particular facts and circumstances disclosed by the evidence in each case.

In this case, the evidence disclosed (1) the duties of the two managing officers and the services performed by each; (2) their abilities to perform those services; (3) the time they devoted to petitioner's business and operations; (4) the success resulting from employment of their ingenuity,

background of experience, ability, and services; (5) their acceptance of insufficient compensation in immediately preceding periods; (6) the even greater aggregate compensation which would have had to be paid to competent employees for services similar to those performed by petitioner's managing officers, etc.

Cunningham, petitioner's president, never had been a stockholder. [R. 114, 163, 211; see Stip., R. 27.] Nor had he loaned any money to petitioner. [R. 163, 217.] His wife was a stockholder [R. 27], but she did not purchase her stock with funds furnished by her husband. She borrowed from her father. [R. 145, 213.] She did considerable work for petitioner during 1942 for which she neither asked for nor received any compensation [R. 215-216], except for $250.00 in director's fees for ten meetings held between August 28 and December 30, 1942 [R. 218].

It conclusively follows that, as hereinafter shown, despite the Tax Court's conclusion in its opinion to the contrary [R. 60], the salary of $28,000.00 paid Cunningham in 1942 bore no relation to any stock ownership by him and did not represent a distribution of profits in the guise of salary, but was paid solely for services actually rendered. The Tax Court's finding [R. 60] in this connection is clearly erroneous [Assignment 9, R. 75-76].

Morse, petitioner's secretary and treasurer, was a stockholder [R. 27] who extended to petitioner his personal credit on bank loans until petitioner's separate credit was established [R. 29]. He was a person of means, of wide business and financial experience [R. 120], and was the owner of a number of sporting goods stores at the time he became associated with petitioner in 1941 [R. 157]. His wife loaned petitioner $8,500.00 in 1941 [R. 157], but

she never was a stockholder [R. 27]. Morse, however, was a stockholder.

Together, Cunningham and Morse were charged with the management of petitioner's business and affairs. [Ex. L, p. 3, before this Court in original form, pursuant to order, R. 229.] It was so ordered by the directors in their meeting of March 31, 1941 [Ex. L, *supra*], and they did jointly manage petitioner's business and operations.

Petitioner's steadily increasing profits resulted chiefly from the combined ingenuity, abilities, time, energies, and activities of Cunningham and Morse as officer-employees. Their duties and abilities to perform their duties were the causal factors in petitioner's success. The war created a world-wide condition which, while it may have affected many manufacturing businesses somewhat favorably, also multiplied immeasurably their business hazards and management duties and responsibilities. However, the war did not remove competition in petitioner's field. Ability, hard work, sweat, and toil remained the indispensable causal factors in the success attained by Cunningham and Morse for petitioner. Petitioner was not a "war baby," nor can it truthfully be said that the war economy was the primary occasion for its success. It was incorporated April 24, 1940, and its organization meeting was held April 25, 1940. [R. 24-25.]

During 1942, according to the disinterested witness Temple, who was buyer for North American Aircraft Company near Los Angeles, which purchased from petitioner, "there was a great deal of competition" in the aluminum business on the part of the various foundries for the furnishing of aircraft parts. [R. 198-199.] Temple testified [R. 199] that North American had salesmen calling on it every day trying to sell it aluminum castings and

that it was impossible to give all of them orders. Temple's testimony was not contradicted.

Cunningham had charge of petitioner's sales and sales promotion [R. 124-125], for which he was well qualified from past extensive sales experience with manufacturing purchasers. He testified [R. 148] it was a backbreaking job building a foundry, and that if he had had in mind that aircraft would win the war he would have gone into an easier line of endeavor. Furthermore, competition became keener in 1942 because the Alcoa aluminum heat treating process was made available, without royalties, by government direction to all who cared to use it. [R. 155.]

Petitioner's gross sales jumped from $1,227.38 for 1940 [R. 33] to $964,862.25 for 1943 [R. 42]. Its 1942 gross sales were $434,363.44 [R. 33, 38], whereas its 1941 gross sales were $39,996.19 [R. 33, 37]. In 1940, it sustained an operating loss of $1,123.58. [R. 33.] These progressive sales increases clearly were the result of the capable efforts, abilities, and tireless energies of the two managing officer-employees.

In 1941, Cunningham and Morse were faced with the problems of establishing a new foundry plant [R. 28], of building and training entirely new personnel, obtaining the necessary priorities, and the many other difficult details incident to what was the equivalent of establishing a new manufacturing business [R. 121-122].

During 1942, Cunningham and Morse each devoted to petitioner's business and operations 12 to 14 hours a day, seven days a week in many instances, and did night work. [R. 33-34, 125.] This is the equivalent of compressing 18 to 24 months of service into 12 months.

Even during 1941, each devoted his full time to petitioner's business and operations, and received therefor as

compensation the inadequate sum of $1,650. [Stip. 19, R. 33.] For 1940, no salaries whatsoever were paid by petitioner to any of its officers or directors. [Stip. 19, R. 33.]

While Cunningham and Morse jointly managed the affairs and business of petitioner [Ex. L, p. 3], and their duties overlapped, the evidence discloses without contradiction that had petitioner employed a metallurgist, a shipping clerk, an inspector of castings, a superintendent of production and a salesman, to perform those services, it would have cost petitioner considerably more than $42,000 therefor, as shown in Argument IV hereof. Obviously, these and the overlapping executive and managerial duties of Cunningham and Morse were worth well in excess of the aggregate amount of $56,000 actually paid to them. Services such as they performed could not have been procured for less.

It should be borne in mind that Cunningham and Morse enlarged petitioner's new plant from a structure 40 by 60 feet to 80 by 165 feet and equipped it. This expansion was accomplished with small capital earnings and borrowings. Moreover, the addition to petitioner's earned surplus for the year 1942, after payment of taxes and salaries, amounted to approximately $9,000, or six times the $1,500 of capital stock outstanding. In other words, there remained net earnings of $60 for each $10 par value share of stock. The non-payment of dividends in 1942 may be justified and explained by the fact loans for plant expansion purposes were outstanding and had to be repaid. The working capital needs incident to the production of $964,862.25 of gross sales for 1943, more than

twice those of 1942, are clearly apparent. Thus, further explanation for non-payment of dividends in 1942 becomes unnecessary.

It is important to note that the directors voted at least $24,000 of the disputed salaries to each of its two managing officer-employees at the very beginning of the year, *viz.*, on January 5, 1942. [R. 30.] Increases, resulting in the aggregate payment of $28,000 to each officer for 1942, were voted on August 28, 1942, effective as of September 1, 1942. [R. 31.] Both actions by the directors occurred before the year's earnings possibly could be known. This clearly negatives any inference, such as drawn by the Tax Court, that there was a purpose to distribute profits rather than fix reasonable compensation for services.

Moreover, respondent never placed in issue by his answer, or any amendment thereto, the contention that profits or dividends were distributed under the guise of compensation, or salaries. The Tax Court exceeded its authority, therefore, and erred in injecting, and assuming such issue to be involved, in the case. In *Heckett v. Commissioner,* 8 T. C. 841, 844, where respondent in his brief before the Tax Court raised for the first time a contention that certain proceeds from stock should not be treated as payment of salary, the Court held (p. 844) that the pleadings did not cover such question, and as respondent had not injected the question into the proceeding "at the trial, at the latest, as required by the rules of the Court," by moving to amend his answer, the issue "is not properly before" the Tax Court and will not be considered.

When fixing the officers' salaries involved herein, the directors believed them to be fair and reasonable, and so testified. [R. 176-178, 214-216, 163-164.] In this re-

spect, their opinions and action should be controlling in the absence of any contradictory evidence—and there is none.

A case substantially parallel to the case at bar is *Coastal Stevedoring Corp. v. Commissioner,* 3 T. C. M. 453, Docket No. 638, decided May 12, 1944 (C. C. H. Dec. 13,933(M)), in which a $35,000 salary was allowed by the Tax Court to each of taxpayer's two managing officers, and the net income remaining was $28,010.30, the gross receipts were $305,861.60, the increase to earned surplus for the taxable year was approximately $7,000 and no dividends were paid. The taxpayer obtained a new employment during the taxable year, which considerably increased its receipts. The Commissioner disallowed $15,000 of each of the two $35,000 salaries claimed, and the Tax Court sustained each $35,000 salary as reasonable, notwithstanding the fact each officer owned half of the ten outstanding shares of stock and their salaries had risen from $5,500 each in 1935 to $35,000 in 1941, the taxable year.

In the instant case, petitioner's net income remaining after $56,000 of officers' salaries, and directors' fees, was $29,828.39, the gross receipts were $434,363.44, the increase to earned surplus for the taxable year was about $9,000, only one of the two managing officers was a stockholder, and the salaries were only $28,000 each.

Here, as in the *Coastal Stevedoring* case, *supra,* the Commissioner's reduction of the salaries paid is not explained in the deficiency notice except that the amount disallowed is determined to be "excessive" compensation for the "services rendered by" the "officers." [Ex. A of Petition, R. 16.]

It is submitted that the Tax Court's findings that $10,000 each to Cunningham and Morse for 1942 consti-

tuted a reasonable allowance for services rendered, is contrary to the undisputed evidence and clearly erroneous [Point (d), R. 224]; also that the Tax Court clearly erred in failing to find and conclude that not less than $28,000 to each was a reasonable allowance for salary for services rendered by Cunningham and Morse to petitioner in 1942, under uncontradicted evidence. [Point (g), R. 225; Assignments 11 and 13, R. 76.] Accordingly, the Tax Court erred in entering decision for respondent, in not entering decision for petitioner, and in failing to find and conclude that there were no deficiencies for 1942. [Points (a), (b) and (c), R. 224.]

Moreover, in the light of the pleadings, stipulated facts, the documentary evidence and undisputed testimony, the Tax Court's ultimate findings and conclusions are clearly without support. [Points (e) and (f), R. 224-225.]

Conclusion.

The decision of the Tax Court should be reversed and remanded with instructions that it enter its decision that there is no deficiency in respect of petitioner's 1942 profits taxes, or in the alternate, that a rehearing *de novo* be granted.

Respectfully submitted,

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May, 1949.

APPENDIX.

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

(1) Trade or business expenses.—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *

* * * * * * * * *

SEC. 1116. HEARINGS.

* * * Hearings before the Board and its division shall be open to the public, and the testimony, and, if the Board so requires, the argument shall be stenographically reported. * * *

SEC. 1117. REPORTS AND DECISIONS.

* * * * * * * * *

(b) INCLUSION OF FINDINGS OF FACT OR OPINIONS IN REPORT.—It shall be the duty of the Board and of each division to include in its report upon any proceeding its findings of fact or opinion or memorandum opinion. The Board shall report in writing all its findings of fact, opinions and memorandum opinions.

* * * * * * * * *

SEC. 1118. PROVISIONS OF SPECIAL APPLICATION TO DIVISIONS.

(a) HEARINGS, DETERMINATIONS, AND REPORTS.—A division shall hear, and make a determination upon, any proceeding instituted before the Board and any motion in connection therewith, assigned to such division by the chairman, and shall make a report of any such determination which constitutes its final disposition of the proceeding.

SEC. 1141. COURTS OF REVIEW.

(a) JURISDICTION.—The Circuit Courts of Appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in Section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; * * *.

Rules of Practice Before the Tax Court of the United States:

RULE 35.—BRIEFS.

The form of all briefs shall be as follows:

* * * * * * * * *

(b) The party having the burden of proof shall set forth complete statements of the facts based upon the evidence. Each statement shall be numbered, shall be complete in itself, and shall consist of a concise statement of the essential fact and not a discussion or argument relating to the evidence or the law. Reference to the pages of the transcript or the exhibits relied upon in support thereof shall be inserted after each separate statement.

If the other party disagrees with any or all of the statements of fact, he shall set forth each correction which he believes the evidence requires and shall give the same numbers to his statements of fact as appear in his opponent's brief. His statement of fact shall be set forth in accordance with the requirements above designated.

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (a)-1. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business * * *.

SEC. 19.23 (a)-6. *Compensation for personal services.*—Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. * * *

* * * * * * * * *

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. * * *